

**Franchise Tax Board****ANALYSIS OF AMENDED BILL**

Author: Budget and Fiscal Review Analyst: Anne Mazur Bill Number: SB 98  
Related Bills: See Legislative History Telephone: 845-5404 Amended Date: July 20, 2007  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Members Of Apportioning Trade Or Business May Elect To Use Alternative Formula/Motion Picture And Commercial Production Credits/Research Expense Credit/Alternative Incremental Research Credit Conformity/Repeal December 31, 2013

**SUMMARY**

Under the Personal Income Tax and Corporation Tax laws, this bill would do the following:

- Create tax credits based on certain wages paid or amounts paid to purchase or lease certain property used to produce motion pictures or commercials in California. (Page 4.)
- Eliminate California Alternative Incremental Research Credit (AIRC) modifications and repeal the Research Expense Credit as of December 31, 2013. (Page 16.)

Under the Corporation Tax Law, this bill would do the following:

- Provide an alternative apportionment method for corporations to assign income to California. (Page 19.)

This bill would also add provisions to the Sales and Use Tax Law (SUTL). This analysis will not address these changes because they do not impact the department or state income tax revenue.

Each provision is discussed separately in this analysis. This is the department's first analysis of this bill.

**SUMMARY OF AMENDMENTS**

The July 20, 2007, amendments deleted intent language relating to the 2007 budget and would add or amend provisions of the Revenue and Taxation Code (R&TC) relating to franchise or income tax business incentives and apportionment methods.

**PURPOSE OF THE BILL**

It appears that the purpose of this bill is to increase economic productivity in California and encourage certain industries to invest in California.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Selvi Stanislaus

8/16/07

**EFFECTIVE/OPERATIVE DATE**

This bill would be effective January 1, 2008. This bill provides the following operative dates for each of the following provisions:

- **Motion Picture and Commercial Production Credits:** This provision would be operative for taxable years beginning on or after January 1, 2008, and before January 1, 2014. By its terms, the provisions would be repealed on January 1, 2014. The bill also specifies that the amount upon which the motion picture credit is based does not include any qualified wages paid or incurred for services performed or any qualified property purchased or leased before January 1, 2008. In addition, the bill specifies that qualified production costs for a qualified commercial do not include costs for story, script, or scenario to be used for a qualified commercial or qualified wages paid or incurred before January 1, 2008.
- **Research Credit:** This provision would be operative for taxable years beginning on or after January 1, 2008, and the credit would be repealed on December 31, 2013.
- **Apportionment Method:** This provision would be operative for taxable years beginning on or after January 1, 2009, and before January 1, 2014, and repealed on December 1, 2014. Current law would be operative again for taxable years beginning on and after January 1, 2014.

**POSITION**

Pending.

**Summary of Suggested Amendments**

Technical amendments 1 through 11 are attached to correct incorrect phrases and references.

**SUMMARY OF ECONOMIC IMPACT**Revenue Estimate

Estimated Revenue Impact of SB 98 Effective for Taxable Years BOA January 1, 2008 Assumes Immediate Enactment (\$ in Millions)				
	2007/08	2008/09	2009/10	2010/11
Motion Picture/Commercial Production Credits	- \$5	- \$40	- \$70	- \$90
Research Credit	/a	- \$5	- \$5	- \$5
Apportionment Formula	None	- \$55	- \$255	- \$475
<b>Total Revenue Impact of this Bill</b>	- \$5	- \$100	- \$330	- \$570

/a: Revenue loss of less than \$1 million.

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

## Revenue Discussion

The revenue impact of this proposed bill was estimated as follows:

### **Motion Picture/Commercial Production Credits**

The impact of both the motion picture and the commercial production tax credits is dependent on the amount of qualified wages and qualified tangible personal property purchased or leased and the portion of the allocated credit that is used to reduce tax liabilities.

Based on employment data for the film/video production industry in California and adjusting for tangible personal property, total credits for qualified wages and property are anticipated to exceed the combined annual credit cap of \$75 million.

The \$75 million of allocated credits are adjusted for the following reasons:

- Projects are completed, on average, over a three-year period,
- Projects approved by the California Film Commission (CFC) are subsequently abandoned and therefore credits would be reallocated in later years, and
- Allow time for the Commission to establish the approval process.

Credits generated for the 2008 taxable year are projected to be \$60 million derived as follows:

\$75 million in credits x 80% (percentage of films that begin production in 2008 or before and are completed in 2008, adjusted for films that a credit is allocated in 2008, but which is subsequently abandoned and therefore must be reallocated in later years).

Unused credits may be carried over for six years. A qualified taxpayer may sell their credits attributable to an independent film or commercial production, as defined, to an unrelated party. Therefore, it is assumed that of the combined \$60 million credits generated during 2008, on average, taxpayers will use 81% or \$49 million of these credits, leaving carryover credits of \$11 million (\$60 million - \$49 million). It is assumed that carryover credits will be used, on average, over two years.

### **Research Credit**

The impact of higher AIRC research credit rates on corporate returns was estimated through simulations using the 2005 sample of corporate returns. These simulations took into account corporations' generation of research credit, other credit availability including credit carryovers from prior tax years, and tax liability. The impact of higher AIRC research credit rates on individual returns was assumed to be equal to 5% of the impact on corporate returns. The repeal of both regular and AIRC research credits after January 1, 2014, would stop the generation of new research credits, but not the use of research credit carried over from prior years. This repeal is estimated to reduce the amount of research credit claimed by about \$600 million per year for the tax years after January 1, 2014.

### **Apportionment Method**

The impact of higher sales-factor weights was simulated using samples of corporate tax returns for the tax years 2003, 2004, and 2005. The simulations accounted for the taxpayers' specific financial situation as reported on their tax returns. These tax amounts were compared with the tax amount calculated under current law. It was assumed that a taxpayer would choose the apportionment formula that yields the lowest tax. The revenue impact of this provision for the 2005 tax year was estimated as the average amount of tax reduction of these tax years. The language of this provision is not clear on the issue of whether or not members of an apportioning trade or business may make separate elections for the alternative apportionment method. The above estimates assume no separate elections. However, if the members are allowed to make separate elections the revenue losses would be higher: -\$0, -\$70 million, -\$320 million, -\$600 million for the tax years 2007/2008 to 2010/2011, respectively.

### **Assumptions and Fiscal Year Estimates**

The estimated 2005 revenue impact for the above three provisions were extrapolated to future years. This extrapolation took into account the growth of the taxpayers' income and the assumption that higher sales-factor weights would yield larger tax savings in subsequent years as the sales-factor weights are accumulated each year. It was assumed that taxpayers' income would grow at the same growth rate as corporate profits as forecasted by the Department of Finance.

Finally, the tax year estimates of the above three provisions were converted to fiscal year estimates shown in the table. For example, the 2009/2010 cash flow estimates of the revenue loss for the above three provisions are \$70 million, \$5 million, and \$255 million, respectively, for a total revenue loss of \$330 million. This \$330 million loss includes a \$115 million loss from the 2009 tax year plus \$215 million loss from the 2010 tax year due to higher credit use and reduced estimated tax payments.

## **QUALIFIED MOTION PICTURE CREDIT AND COMMERCIAL PRODUCTION CREDIT**

### **ANALYSIS**

#### **FEDERAL/STATE LAW**

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business (e.g., employee wages and benefits). When a taxpayer produces or creates a product (e.g., video, film, etc.), the taxpayer will generally incur a major portion of the expenses before the product begins to produce income. When this occurs, the taxpayer is usually required to capitalize those expenses and amortize—recover or deduct—they over the period that the product produces income using a specialized cost recovery method called the "income forecast" method. Amortized expenses include costs of researching, preparing, producing, recording, and other direct production costs. It also includes an allocation of indirect costs such as utilities, tools, clerical expenses, and equipment rental.

The federal American Jobs Creation Act (AJCA) of 2004 contains provisions that impact the income tax treatment of motion picture productions. Effective for productions commencing after October 22, 2004, and before January 1, 2009, the AJCA permits qualifying film and television productions to elect to deduct certain production expenditures in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances under the income forecast method discussed above. This provision only applies to qualified productions, the aggregate cost of which does not exceed \$15 million. For this purpose, a qualified film or television production is defined as any production of a motion picture, miniseries, scripted, dramatic television episode, or movie of the week if at least 75% of the total compensation expended on the production is for services performed in the United States. For an episodic television series, only the first 44 episodes qualify under the provision. The AJCA modifies the income forecast method to include certain participations and residuals in the adjusted basis of the property. The AJCA also allows a deduction equal to a portion of the taxpayer's qualified domestic production activities, including any disposition, lease, rental, or license of qualified film produced by the taxpayer. California has not conformed to the AJCA provisions.

Current state and federal laws do not provide any tax credits relating to production of commercials or motion pictures.

#### THIS PROVISION

This provision would create two credits. Each credit will be discussed separately.

Applicable to both credits, this bill would require the California Business, Transportation and Housing Agency (BT&H) to report to the Legislature by December 31, 2011, on the economic impact of these credits. The bill would authorize BT&H to consult with other organizations and government agencies, including the Franchise Tax Board (FTB), before completing the report. This bill would also require the CFC to report to the Legislature annually beginning June 1, 2011, on the diversity of the workforce employed by recipients of credits in the production of qualified motion pictures or commercials.

This provision contains special rules for both credits that appear to provide that in the case of an S corporation, the credit can be claimed only by the shareholders and not the S corporation.

The provision provides that the amount of a credit allowed to the qualified taxpayer must be treated as income of the qualified taxpayer from a source wholly within this state for the taxable year in which the credit is allowed.

The bill also would provide that its provisions are severable if any are invalidated.

#### **Qualified Motion Picture Credit**

This bill would create a franchise or income tax credit to a qualified taxpayer, as defined, for a percentage of the wages paid or amounts paid to purchase or lease tangible personal property used in the production of a qualified motion picture, as defined, in California that is allocated and certified by the CFC. Any credit unused in a taxable year because it is in excess of the taxpayer's tax liability could be carried over for six taxable years.

For credits attributable to an independent film, the qualified taxpayer would be permitted to sell a credit to an unrelated party. The qualified taxpayer would be required to report to FTB prior to the sale of the credit "all required information" in the form and manner specified by FTB. Credits could not be sold to more than two successive taxpayers. An independent film would be defined as a film with a minimum budget of \$1 million and maximum budget of \$10 million, produced by a company that is not publicly traded, and publicly traded companies do not own, directly or indirectly, more than 25% of the producing company.

In accordance with rules and regulations required to be promulgated by the CFC by March 1, 2008, qualified taxpayers must comply with audit requirements prior to the issuance by CFC of the certified allocation amount. The credit would be disallowed, without appeal rights, if the certification is not attached to the return claiming the credit. The CFC would also be required to establish an appeals procedure to resolve disputes regarding the amount of the certified credit allowed.

The following chart illustrates the criteria for the credit and generally how it would function.

**Credit Amount** – In general. 12% of the “qualified amount” of wages and property during the production period of a “qualified motion picture.”

**Additional 3% for movie of the week and miniseries.**

**Maximum Credit:**

**The lesser of:** The amount of initial credit allocation; the amount of credit based on actual allowable expenditures on completion; or \$3 million per qualified motion picture.

**Qualified Wages** –

Wages and certain fringe benefits paid or incurred by the production company with respect to a qualified individual for services performed on a qualified motion picture in this state.

**Qualified Property** –

Tangible personal property purchased or leased in California that is used primarily in the production of a qualified motion picture.

### Qualified Motion Picture Credit

#### Initial Allocation

Taxpayer's apply to CFC for initial allocation on first-come-first-served basis under CFC regs.

#### Filming Starts

Taxpayer uses initial allocation for financing and begins filming within 180 days of initial allocation.

#### Picture Complete

Motion picture completed w/i 30 months; taxpayer meets CFC audit requirement; and makes irrevocable election to claim credit.

**Final Certification** – CFC makes final certification of **qualified taxpayer**; **name of film**, **amount of credit** allowed to each; and **notifies** qualified taxpayer and FTB.

**Taxpayer Claims Credit on franchise tax or income tax return.**

#### **Qualified Motion Picture**

**In general.** A motion picture produced for exploitation in theaters, TV, videotapes, videodiscs, DVDs, or any other digital format or on commercial carriers and at least 75% of the total days spent in principal photography occur wholly in California.

#### **Budget**

**requirements.** A **feature film** qualifies if it has a minimum budget of \$1 million and a maximum budget of \$75 million. A **movie of the week or miniseries** qualifies if it has a minimum budget of \$1 million and a maximum budget of \$75 million.

**TV Episode:** a single episode in a single season (not exceeding 22 episodes per season) of a TV series that is **new to California** with a minimum budget of \$500,000 and a maximum budget of \$1.8 million per episode. (limited to 1<sup>st</sup> 3 seasons new to CA.)

#### **Maximum Allocation**

– An amount equal to \$70 million for each calendar year, plus unused credit allocations.

“Qualified amount” does not include any of the following:

- Wages paid or incurred for services performed before January 1, 2008.
- Qualified property purchased or leased before January 1, 2008.

“Qualified motion picture” does not include any of the following:

- Motion picture produced:
  - for private noncommercial use, such as weddings or graduations,
  - by students made as part of any educational course, or
  - for industrial purposes.
- News program, current events or public events program, talk show, game show, sporting event or activity, or awards’ show.
- Telethon or other production that solicits funds.
- Reality television program.
- A feature where 80% or more of the content consists of computer-generated images.
- Clip-based programming if more than 50% of the content is comprised of licensed footage.
- Documentary.
- Variety program.
- Daytime drama.
- Strip show.
- One-half-hour (air time) episodic television show.
- Any production that falls within the record keeping requirements of Section 2257 of Title 18 of the U.S. Code.

“Qualified wages” does not include any of the following:

- Expenses, including wages, in excess of the first \$25,000 paid per person per qualified motion picture for writers, directors, music directors, music composers, music supervisors, producers, and performers, other than background actors with no scripted lines.
- Expenses, including wages, for legal or accounting services except production accountants.
- Expenses, including wages, related to new use, reuse, clip use, licensing, secondary markets, or residual compensation, or the creation of any ancillary product, including, but not limited to, a soundtrack album, toy, game, trailer, or teaser.
- Expenses, including wages, paid or incurred with respect to acquisition, development, turnaround, or any rights thereto.
- Expenses, including wages, related to financing, overhead, marketing, promotion, or distribution of a qualified motion picture.

“Qualified property” does not include any of the following:

- A story, script, or scenario to be used for a qualified motion picture.
- The literary, dramatic, or musical material upon which the qualified motion picture is based or may be adapted.
- Any rights relating to the two preceding items.

### **Commercial Production Credit**

This provision would also allow a franchise or income tax credit to a commercial production company for a percentage of the incremental production costs of producing a qualified commercial in California that is allocated and certified by the CFC. Any credit unused in a taxable year because it is in excess of the taxpayer's tax liability would be carried over up to six years.

For credits attributable to an independent production, the qualified taxpayer would be permitted to sell a credit to an unrelated party. The qualified taxpayer would be required to report to FTB prior to the sale of the credit “all required information” in the form and manner specified by FTB. Credits could not be sold to more than two successive taxpayers. An independent production would be defined as a commercial production with a minimum budget of \$1 million and maximum budget of \$10 million, produced by company that is not publicly traded, and publicly traded companies do not own, directly or indirectly, more than 25% of the producing company.

In accordance with rules and regulations required to be promulgated by the CFC by March 1, 2008, qualified taxpayers must comply with audit requirements prior to the issuance by CFC of the certified allocation amount. It appears the credit would be disallowed, without appeal rights, if the certification is not attached to the return claiming the credit. The CFC would also be required to establish an appeals procedure to resolve disputes regarding the amount of the certified credit allowed.

The following chart illustrates the criteria for the credit and generally how it would function.

## Commercial Production Credit

**Credit amount** – 12% of the incremental qualified production costs.

**Maximum credit** –

**The lesser of:** \$500,000 per qualified production company per calendar year, or the credit allocated by the CFC to the qualified commercial production company.

**Incremental qualified production costs** –

Qualified production costs for the taxable year greater than the qualified production costs for the base year.

**Qualified production costs** – Costs for

tangible property used and services directly and predominantly in the production of a qualified commercial. Costs for qualified wages, technical and crew production costs, certain depreciation, equipment and services for postproduction, and other specified expenses.

Qualified commercial production company applies to CFC for credit allocation.

Application must contain qualified production costs for the base year and the taxable year.

If limit exceeded, CFC aggregates all applications within 120 days of due date and makes pro rata allocation.

**Certification** – CFC makes certification of **qualified taxpayer**; **amount of credit** allowed to each; and **notifies** qualified taxpayer and FTB.

**Taxpayer Claims Credit on franchise tax or income tax return.**

**Qualified commercial**

A commercial or advertisement composed of moving images and sounds that is recorded on film, videotape, or other digital medium, created for display on a network, regional channel, or cable where 75% of the total production days occur wholly in California.

**Maximum allocation**

– An amount equal to \$5 million for the 2008 calendar year, plus unused credit allocations.

**Pro rata allocation** –

If the amount allocable to commercial production companies exceeds maximum amount allowed to be allocated in any year, the CFC is required to make a pro rata allocation of that maximum amount.

“Qualified commercial” does not include any of the following:

- Program length production with an advertising component including a documentary length commercial.
- An infomercial.
- A news or current affairs program.
- Interview or talk program.
- Network promotion (short-form content intended to promote other programming).
- Game show, sporting event, or award ceremony.
- Daytime drama.
- Reality entertainment programming.
- Program intended primarily for industrial, corporate, or institutional end users.
- Fundraising or political commercial.
- A program consisting primarily of stock footage.
- A program produced by an organization organized under Section 527 of the Internal Revenue Code, relating to political organization.
- Any production that falls within the record keeping requirements of Section 2257 of Title 18 of the U.S. Code.

“Qualified production costs” do not include costs for any of the following:

- A story, script, or scenario to be used for a qualified commercial.
- Qualified wages paid or incurred before January 1, 2008.

“Qualified wages” do not include wages, salaries, or other compensation for any of the following:

- Writers,
- Directors,
- Music directors,
- Producers, and
- Performers (other than background actors with no scripted lines who are employed by a qualified commercial production company).

## IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

1. The commercial production credit would be a credit on incremental costs; however, the bill contains no mechanism to prevent a production company from creating a new production entity for each commercial production and claiming the credit on the full amount of, rather than the incremental, costs. It is recommended that anti-abuse language be added to the statutory scheme.
2. This provision would authorize the CFC to designate and allocate the credits to qualified taxpayers and qualified commercial production companies. The bill would also require such taxpayers to substantiate specified information or the credits would be disallowed; however, it is not clear whether this substantiation is made to the CFC or to FTB.

3. This provision would allow credits attributable to an independent film or production to be sold to an unrelated party. It is unclear what limitations, if any, would be applicable regarding this sale.
  - a. It is unclear what would happen if a taxpayer sells a credit, and the credit is partially or completely disallowed in a subsequent audit by the department. This would be an especially acute problem if the seller is either no longer in existence or no longer subject to California's taxing jurisdiction. It is recommended that the statutory scheme expressly state that the department has authority to adjust the tax liability of the purchaser and reclaim the credit amount, with interest, from the seller.
  - b. Because there may be occasion where the department's audit of the seller's tax return may occur under a waiver of the statute of limitations, it may become necessary for the department to request waiver of the purchaser's statute of limitations to prevent the department from being prohibited from adjusting the purchaser's tax liability when the department determines that part or all of the claimed credit should never have been allowed.
  - c. The department would need to be specifically authorized to disclose the necessary confidential tax information of the seller to the purchaser in such an audit situation.
  - d. The purchaser would need statutory authorization to obtain tax information from the seller about the circumstances surrounding the credit that was sold in order to defend a subsequent proposed adjustment by the department.
  - e. If the credit is disallowed only in part upon FTB audit, it is unclear how this disallowance would be allocated between the seller and the purchaser, particularly if the statute of limitations has expired for one, but not both, of the affected taxpayers.
  - f. The provision does not specify when the purchaser-taxpayer can use the sold credit. It could be used in the same year as the seller earned the credit or it could be used in the taxable year succeeding the taxable year of sale and subsequent taxable years, similar to a carryover. In addition, it is unclear what the applicable carry forward period would be for credits that are sold. Absent clarification, the department would interpret the language to provide the same carryover period as would apply to the qualified taxpayer based on expenditures generating the credit.
  - g. The tax consequences for the sale of the credit, such as recognition of income to seller or purchaser or a required basis computation, are unclear.
  - h. The mechanics of the election to sell the credit should be developed to require a formal election on a timely filed original return.
4. In defining a "qualified motion picture," the bill states that, in computing total wages paid or incurred for the production of a qualified motion picture, all amounts paid or incurred by all persons or entities that share in the costs of the qualified motion picture shall be *aggregated*. Aggregation language appears to contemplate various persons paying wages in connection with the production of a motion picture. This seems to conflict with the fundamental definition of a "qualified taxpayer" as being that taxpayer who has paid or incurred the expenses for the qualified amount.

5. The definition of “qualified motion picture” and “qualified commercial” would require at least 75% of the “total production days” to occur wholly within California on or after January 1, 2008. Staff notes the following concerns with this requirement:
  - a. With respect to “total production days,” department staff assumes this means a California production day is a day of production occurring exclusively in California and that at least 75% of all production days must be California production days. If staff's understanding of the author's intent on this point is correct, then the bill should be clarified accordingly.
  - b. The bill does not define “production” day. It is not clear whether such “production” would include only principal photography or whether it also would include preproduction and postproduction.
6. For the motion picture production credit, the bill states that property is qualified if it is purchased or leased in California and used primarily in the production of a qualified motion picture. Department staff recommends the term “used primarily” be clearly defined to avoid disputes regarding how much use would be required. The definition could be based, for example, on the percentage of time the property is used in the production of a qualified motion picture.
7. For the commercial production credit, the bill states that property and services are qualified if used directly and predominately in the production of a qualified commercial. Department staff recommends the term “directly and predominantly” be clearly defined to avoid disputes regarding how much use would be required.
8. The bill states that the credits would be denied unless the taxpayer substantiates by adequate books and records that the wages and property were paid in the amount claimed and that the motion picture or commercial was qualified. Amounts paid and incurred should be reflected in the production entity's properly maintained books and records. Department staff recommends that the substantiation standards included in the bill be deleted because a general substantiation requirement already exists in current law. Use of such standards in the bill might suggest that the standard for this credit is different than the general requirement.
9. Various film industry terms are used throughout this bill without definition, such as “production period” or “principal photography.” Department staff recommends that these terms be clearly defined to simplify administration and avoid disputes.
10. The language of the provision would appear to allow a motion picture or commercial that was already in production prior to January 1, 2008, or prior to approval of the CFC, to apply and be approved for and allocated credits. If it is the author's intent to limit the credit to productions that begin after CFC approval, language should be added to the bill clarifying that intent.

#### TECHNICAL CONSIDERATIONS

1. It appears the intention of this provision is to allow the credit only at the shareholder level and not to allow an S corporation to reduce entity level tax by any portion of such credit. If this assumption is correct, there are provisions of the provision that are incompatible and internally inconsistent. The provision, however, would deny the credit to an S corporation only for taxes imposed under Chapter 4.5 (commencing with R&TC section 23800). Pursuant to section 23802, an S corporation is subject to the tax imposed under Chapter 2 (section 23101) and Chapter 3 (23501), but at a reduced rate (i.e., the 1½% entity-level tax).

Chapter 4.5 only imposes the built-in gains tax and the tax on passive income. In addition, this provision appears to be in conflict with another provision<sup>1</sup> in the bill that would require an S corporation to reduce the credit allowed “under this section” in an amount equal to the amount of the credit claimed by the shareholders. If the intent is to prohibit an S corporation from using the credit against any of those taxes, including the 1½ % tax, the reference should be corrected accordingly and the conflicting language should be deleted.

2. This provision would allow the motion picture/commercial production credits to be claimed for taxable years beginning on or after January 1, 2008, and before January 1, 2014. The credits would be repealed on January 1, 2014. If the author’s intent is to allow the credits for taxable years beginning on or after January 1, 2008, and before January 1, 2014, the repeal date should be no earlier than December 1, 2014. This would allow fiscal year filers with taxable years beginning in 2013, ending in 2014, and that incur qualified costs in 2014 to claim the credit for that fiscal year. The author may wish to amend the bill to revise the repeal date to January 1, 2015, or to December 1, 2014, to include the last fiscal year.
3. The provision appears to allow a six-year carryover period for both the motion picture and commercial production credits; however, the provisions permitting such carryover should reside in separate subdivisions rather than be included in the subdivisions relating to the sale of credits attributable to independent film or commercial production.
4. Both credit provisions would require FTB to disallow the credit without appeal rights if the qualified taxpayer fails to attach the credit certification “in accordance with subdivision (h)”; however, subdivision (h) does not contain such a requirement.
5. The bill would amend R&TC section 23036 to add credits that contain refundable provisions to the order in which credits can be taken against tax. This amendment appears to be an error because none of the provisions in this bill provide refundable credits. Amendment 8 is provided to correct this error.
6. In addition, staff identified grammatical and reference errors. Amendments 1 through 11, exclusive of 8, attached to this analysis are provided to correct these issues.

## LEGISLATIVE HISTORY

SB 740 (Calderon, 2007/2008) would permit a nonrefundable transferable motion picture production credit. This bill is currently in the Senate Revenue and Taxation Committee.

AB 777 (Nunez, 2005/2006) would have provided refundable credits otherwise similar to this bill. This bill was held in the Senate Revenue and Taxation Committee.

SB 58 (Murray, 2005/2006) would have provided a refundable franchise and income tax credit for certain wages paid or amounts paid to purchase or lease certain property used to produce a motion picture in California. This bill was held in the Senate Revenue and Taxation Committee.

---

<sup>1</sup> On page 45, beginning on line 38 and page 52, beginning on line 39.

AB 1830 (Cohn, 2003/2004) and AB 2747 (Wesson, et. al., 2001/2002) would have provided a refundable income tax credit for wages paid in connection with the production of a motion picture in California. AB 1830 did not pass out of the Assembly policy committee. AB 2747 did not pass out of the Senate Appropriations Committee.

AB 484 (Kuehl, 1999/2000), as amended July 14, 1999, would have provided a refundable income tax credit for wages paid in connection with the production of or musical scoring for certain television programs or motion pictures. As enacted, AB 484 (Stats. 1999, Ch. 699) created the Film California First Program within the Technology, Trade, and Commerce Agency to assist in the underwriting of actual costs incurred by production companies filming in California.

AB 358 (Wildman, 1999/2000) would have provided a refundable income tax credit for wages paid in connection with television programs or motion pictures similar to AB 484. AB 358 did not pass out of the Senate Appropriations Committee.

## **OTHER STATES' INFORMATION**

Numerous states and foreign jurisdictions provide incentives to the motion picture industry. Attached as an appendix to this analysis is a table compiled by the Motion Picture Association of America, Inc., summarizing these incentives.

## **FISCAL IMPACT**

The estimated cost to implement this provision would be approximately \$70,000 for modification of the individual and corporate tax systems to accommodate the new credits and other automated and manual return processing functions. Such functions would include the development of a process to track sales and purchases of credits originally allocated to qualified taxpayers. Estimated annual costs to process returns claiming the credit would be approximately \$120,000. It is assumed that FTB's activities to administer this provision would be limited to verifying that the taxpayer claiming the credit is in fact the qualified taxpayer allocated credits by the CFC or purchaser of such credits, and then making or denying the credit as applicable. It is recommended that the bill be amended to include appropriation language that would provide funding to implement this provision. Lack of an appropriation will require the department to secure the funding through the normal budgetary process, which will delay implementation of this provision.

## **ECONOMIC IMPACT**

See Summary of Economic Impact section of this analysis above.

## **LEGAL IMPACT**

This bill would require taxpayers to produce motion pictures or commercials in the state to qualify for the credit. This requirement may be subject to constitutional challenge under the Commerce Clause of the United States Constitution.

## **ARGUMENTS/POLICY CONCERNS**

1. This bill provides that the CFC would allocate credits to a qualified taxpayer or qualified commercial production company based on information required to be included with the taxpayer's application and certify the allowed credits upon completion of the motion picture or commercial in accordance with rules and regulations promulgated by the CFC. Because the bill would require the CFC to certify the allowed credit prior to being claimed on a franchise or income tax return, FTB administration of the credit would be limited to verifying that the taxpayer claiming the credit is in fact the qualified taxpayer allocated credits by the CFC, or a purchaser of allocated credits, and then making or denying the credit as applicable. In this regard, administration of the credit would be relatively simple. FTB currently administers the low-income housing credit and the natural heritage preservation credit, both of which are allocated by a designated agency, in this manner. However, if the allocation certification feature were eliminated or if the bill is intended to require FTB to examine returns subsequent to the taxpayer claiming the credit, such examinations would be lengthy, complex, and costly.
2. Conflicting tax policies result when a credit is provided for an item that is already deductible as a business expense or is depreciable, resulting in a double tax benefit. On the other hand, making an adjustment to reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.
3. Conflicting tax policies result when an expenditure qualifies for more than one credit, resulting in a double tax benefit. For example, expenditures eligible for this credit might also qualify for the Hollywood<sup>2</sup> enterprise zone credit. It is suggested that the bill be amended to prevent a taxpayer from claiming any other credit with respect to any qualified expenditure on which a motion picture production credit or a commercial production credit is claimed.

## **RESEARCH CREDIT**

### **ANALYSIS**

#### **FEDERAL/STATE LAW**

Existing federal law allows taxpayers a research credit in the amount of 20% of the excess qualified research expenses. The research credit is designed to encourage companies to increase research and development activities.

To qualify for the credit, research expenses must qualify as an expense or be subject to amortization, be incurred in the U.S., and be paid by the taxpayer. The research must be experimental or laboratory research and pass a three-part test as follows:

1. Research must be undertaken to discover information that is technological in nature. The research must rely on the principles of physical, biological, engineering, or computer sciences.

---

<sup>2</sup> Los Angeles, the East Valley, Hollywood, and Central L.A. have received conditional designation from the Department of Housing and Community Development to offer tax incentives during a zone redesignation period. Numerous other areas in California also have conditional designation as enterprise zones.

2. Substantially all of the research activities must involve experimentation relating to quality or to a new or improved function or performance.
3. The application of the research must be intended for developing a new or improved business component. This is a product, process, technique, formula, or invention to be sold, leased, or licensed or used by the taxpayer in a trade or business.

Ineligible expenses include seasonal design factors; efficiency surveys; management studies; market research; routine data control; routine quality control testing or inspection; expenses incurred after production; or development of any plant, process, machinery, or technique for the commercial production of a business component unless the process is technologically new or improved.

The federal credit does not apply to any expenses paid or incurred after December 31, 2007.

California conforms to the federal credit with the following modifications:

- The state credit is not combined with other business credits.
- Research must be conducted in California.
- The credit percentage for qualified research expenses in California is 15% versus the 20% federal credit.
- The credit percentage for basic research payments in California, limited to corporations, is 24% versus the 20% federal credit.
- The California alternative incremental research expense credit (AIRC) rates are 1.49%, 1.98%, and 2.48% versus the federal rates of 3%, 4%, and 5%, respectively.

The California research credit is allowed for taxable years beginning on or after January 1, 1987, and is permanent without regard to whether the federal credit is operative.

### THIS PROVISION

This provision would amend California's modified adoption to the AIRC rates by removing those modifications for taxable years beginning on or after January 1, 2008, which would result in conformity with the federal AIRC provisions.

This provision would also add a repeal date of December 31, 2013, which would repeal the entire Research Expense Credit.

### IMPLEMENTATION CONSIDERATIONS

Implementing this provision could be accomplished during the department's normal annual updates.

### **LEGISLATIVE HISTORY**

SB 359 (Runner, 2007/2008) would, among other things, increase the Qualified Research Expense Credit from 15% to 16% and conform to the federal AIRC. SB 359 is currently in the Senate Revenue and Taxation Committee.

AB 2032 (Lieu, 2005/2006) would have increased the amount of the Qualified Research Expense Credit from 15% to 18%. AB 2032 failed to pass out of the Assembly Revenue & Taxation Committee.

AB 2567 (Arambula, 2005/2006) would have conformed the amount of the Qualified Research Expense Credit to the amount allowed at the federal level. AB 2567 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 483 (Harman, 2001/2002) and SB 1165 (Brulte, 2001/2002) would have increased the credit for qualified research expenses from 15% to 20%. AB 483 was held in the Senate Revenue and Taxation Committee. SB 1165 failed to pass out of the originating house by the constitutional deadline.

AB 511 (Stats. 2000, Ch. 107) increased the state credit for qualified research expense from 12% to 15%.

## **OTHER STATES' INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Florida* allows corporate taxpayers to claim a corporate income tax credit for tax years beginning on or after January 1, 2007, for certain "eligible costs" for renewable energy technologies investment. *Florida* lacks a comparable credit for personal income taxpayers because *Florida* has no state personal income tax.

*Illinois* corporate and individual taxpayers may claim an income tax credit for qualified expenditures that are used for increasing research activities in *Illinois*. The credit equals 6 ½% of the qualifying expenditures.

*Massachusetts* allows corporate taxpayers to claim an income tax credit for qualified expenditures that are used for increasing research activities in *Massachusetts*. The credit is 15% of the basic research payments and 10% of qualified research expenses conducted in *Massachusetts*.

*Minnesota* allows corporate taxpayers a credit equal to 5% for qualified research expenses up to \$2 million. The amount of the credit is reduced to 2.5% for expenses exceeding the first \$2 million.

*Michigan* allows corporate taxpayers a credit for pharmaceutical research and for a percentage of the compensation for services paid by the taxpayer that is engaged in research of a hybrid system for propelling motor vehicles. An eligible taxpayer may claim a credit against the Single Business Tax equal to 6.5% of the excess of qualified research expenses paid in the tax year that relate to pharmaceutical-based business activity in *Michigan* paid during the three immediately preceding tax years.

Beginning in 2005, *New York* allows a credit for qualified emerging technology companies. The credit is equal to 18% of the cost of research property, 9% of the qualified research expenses, or the costs of high-technology training expenditures paid by the taxpayer. The credit is limited to \$250,000 per taxable year.

## **FISCAL IMPACT**

This provision would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

See Summary of Economic Impact section of this analysis above.

## **APPORTIONMENT FORMULA**

### **ANALYSIS**

#### **FEDERAL/STATE LAW**

The federal method of taxing corporations doing business within and without a state is different from the California method; therefore, an analysis of federal law is not relevant.

California has adopted the Uniform Division of Income for Tax Purposes Act, (UDITPA), with certain modifications, to determine how much of an apportioning taxpayer's total income, which is earned from activities both inside and outside of California, is attributed to California and subject to California franchise or income tax. "Nonbusiness income," typically income arising from investment activities or activities outside of the regular business of the corporation, is assigned specifically to a state. For "business" income, normally all or almost all of the income of a corporation, UDITPA assigns it by using an apportionment formula.<sup>3</sup>

The apportionment formula consists of property, payroll, and sales factors. The property factor includes tangible property owned or rented and used during the taxable year; the payroll factor includes all forms of compensation paid to employees; and in general, the sales factor is double-weighted and includes all gross receipts from the sale of tangible and intangible property. Traditional UDITPA weights the three factors equally. For 1993 and subsequent years, California determined that the sales factor should be double-weighted for most businesses.

---

<sup>3</sup> "Business income attributable to California" is a taxpayer's "business income" multiplied by its California apportionment formula. Revenue and Taxation Code (R&TC) section 25120(a) defines "business income" as income arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." R&TC section 25120(d) defines "nonbusiness income" as all income other than business income. In general, "business income" is income arising in the normal course of the taxpayer's business or from assets used in the normal course of the taxpayer's business.

The calculation of the apportionment formula and California business income is illustrated below.

$$\begin{array}{c}
\boxed{\begin{array}{c} \text{Average} \\ \text{CA Property} \\ \text{Average Total} \\ \text{Property} \\ \text{Everywhere} \end{array}} + \boxed{\begin{array}{c} \text{CA Payroll} \\ \text{Total Payroll} \\ \text{Everywhere} \end{array}} + (2 \times \boxed{\begin{array}{c} \text{CA Sales} \\ \text{Total Sales} \\ \text{Everywhere} \end{array}}) \\
\hline
4
\end{array} = \text{California Apportionment Formula}$$

$$\begin{array}{c}
\text{X Total Business Income} \\
= \text{California Business Income}
\end{array}$$

An exception to this rule exists for taxpayers that derive more than 50% of their gross business receipts from conducting a “qualified business activity.” These taxpayers are required to use a three-factor, single-weighted sales, apportionment formula. For this purpose, a qualified business activity is defined as an agricultural, extractive, savings and loan, and banking or financial business activity. In addition, current law requires that once a determination has been made that the apportioning trade or business is involved in a qualified business activity, the entire apportioning trade or business uses the same weighting, regardless of whether the particular entity was involved in a qualified business activity.

State law permits a departure from the standard apportionment provisions only in limited cases,<sup>4</sup> and recognizes that the standard apportionment provisions are not appropriate when applied to certain industries and types of transactions, in which case special apportionment provisions exist for those situations.<sup>5</sup>

#### THIS PROVISION

This provision would allow a qualified taxpayer to elect, on behalf of an apportioning trade or business, an alternative apportionment method instead of the standard three-factor apportionment formulas that double weights or single weights the sales factor.

A “qualified taxpayer” is defined as a member of an apportioning trade or business, other than a trade or business that derives more than 50 percent of its gross business receipts from a savings and loan activity, a banking or financial business activity, a real estate activity classified in Sub sector 531 of the North American Industry Classification System (NAICS) 2002 Edition, or an insurance activity that is subject to tax under this part.

The proposed alternative apportionment method provides that for every \$250 million of qualified expenditures incurred by the apportioning trade or business during a taxable year beginning on or after January 1, 2008, an apportioning trade or business may add another sales factor weighting to the apportionment formula. The apportioning trade or business is limited to two additional sales factor weightings each taxable year. Unused additional sales factor weightings would be carried over to the subsequent taxable year.

<sup>4</sup> R&TC section 25137.

<sup>5</sup> California Code of Regulations (CCR), title 18, Section 25137 *et seq.*

If an apportioning trade or business chooses to elect the proposed alternative apportionment method, the changes to the sales factor weightings would remain in effect for all subsequent taxable years that the election is operative.

“Qualified expenditures” means any of the following expenditures that are incurred on or after January 1, 2009:

- Capital expenditures for real and tangible personal property located in this state.
- Expenses incurred to acquire, develop, or license intellectual property in this state.
- Research expenses incurred in California.
- Capitalized rent paid in California in excess of the prior year.
- Compensation and benefits paid to employees in this state that is in excess of the amount paid in the prior year.

An expense that qualifies as a qualified expenditure under two or more categories may only be taken into account once for calculating the total amount of qualified expenditures. Sales, transfers, or other transactions between members of the apportioning trade or business and expenses associated with corporate acquisitions shall not be considered a qualified expenditure.

#### Other Provisions

- The election is required to be made by attaching a statement to a timely filed original tax return. The aggregate information to substantiate the qualifications is required to be submitted.
- The provisions of this bill are severable, so that if any provision or its application is held invalid, that invalidity shall not affect other provisions that can still be given effect without the invalidated provision.
- FTB may prescribe legislative rules and regulations to implement the provisions of this bill.
- A member that makes this election shall not be eligible to utilize any corporation tax credit with respect to any qualified expenditure.
- FTB would be required to report to the Legislature no later than December 1 of each year, beginning with tax year 2010, the fiscal impact of this proposed apportionment method and the aggregate qualified investments for the taxable year.
- The Legislative Analyst, in consultation with FTB and the Department of Finance, would be required to report to the Legislature by February 1, 2014, the revenue and economic impact of this proposed alternative apportionment method and recommendations as to whether these provisions should be continued or modified.
- In the event of an acquisition either by or of a new affiliated member, if the electing member's total business assets exceed the new affiliated member's total business assets, the election will apply to the new affiliate; otherwise, the election would be terminated, but a new election may be made.

## IMPLEMENTATION CONSIDERATIONS

1. The language of this provision is susceptible to different interpretations due to internal inconsistencies in the language. Examples of inconsistencies in the provision are on page 56, line 14, the language provides that a qualified taxpayer may elect, on behalf of an apportioning trade or business, and on page 56, line 38, the language provides that an apportioning trade or business may elect this alternative apportionment method. In addition, on page 58, lines 24 through 32, the rule that provides that the entire business income of the group shall be apportioned using double weighted or single weighted sales was deleted instead of updated to include the proposed apportionment method. These inconsistencies could be interpreted to mean that the election to use the proposed alternative apportionment method applies to the entire apportioning trade or business or to the qualified taxpayer. The provision does not provide a means for reconciling inconsistent positions taking by members of a unitary business and, if different choices could be made, lacks provisions specifying how different members of the same apportioning trade or business would utilize different sales factor weighting.
2. The amendment adding rules for elections when a new affiliate is acquired and the definition of a subgroup refer to "total business assets," which is undefined. The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this bill.
3. It is unclear how the \$250 million requirement would be calculated for intellectual property payments, or any other payments, made to affiliated entities outside the water's-edge group.
4. It is unclear how the provision that disallows any corporate tax credit with respect to any qualified expenditure was intended to apply. Does this provision mean that once an election is made any payment that meets the definition of a qualified expenditure would be disallowed to determine a corporation tax credit? Or, does it mean that only expenditures need to meet the \$250 million threshold could not be used for a credit? If the latter is the meaning, who determines which expenditures are to be used for purposes of the bill and which remain eligible for credit purposes?
5. It is unclear how to determine what portion of an amount paid to acquire, develop, or license intellectual property usable everywhere would be "in this state." If it is intended to apply only to intellectual property located in this state, there will be administrative difficulties in determining the location of intellectual property, which by its very nature does not have a tangible presence and whose "location" can be easily shifted.
6. Costs associated with the purchase of stock and/or assets for corporate acquisitions are excluded from being a qualified expenditure, but it appears that the new payroll costs associated with the corporate acquisition and pre-existing rental payments would be included as a qualified expenditure, which is inconsistent with excluding costs from corporate acquisitions from being qualified expenditures and appears to be inconsistent with purpose of the bill.
7. This bill would allow amounts paid to increase the salaries of current employees to be counted as a qualified expenditure despite the fact that it does not increase California employment.

## TECHNICAL CONSIDERATIONS

1. Page 56, line 25, references January 1, 2008. It appears this date should be January 1, 2009.
2. Page 56, line 27, references "clause (i) of this subparagraph," but there is no clause (i) in the proposed language. It appears the reference should be "subparagraph (A) of this paragraph."
3. Page 58, lines 24 through 32 were deleted. To ensure that all business income is assigned utilizing the same sales factor weighting, this language is necessary.

## **LEGISLATIVE HISTORY**

AB 1591 (Ma, 2007/2008) would create two alternative apportionment methods an apportioning trade or business may elect instead of the standard apportionment formula. AB 1591's Alternative No. 1 provides a business additional sales factor weightings for every \$250 million of qualified expenditures, which is similar to this provision. AB 1591 is currently in the Assembly Revenue and Taxation Committee.

SB 359 (Runner, 2007/2008) would revise the current rules for apportioning business income to allow certain taxpayers an election to use a three-factor, quadruple-weighted sales apportionment formula, remove "extractive business activities" from the definition of a qualified business activity, and add other miscellaneous provisions. SB 359 is currently in the Senate Revenue and Taxation committee.

AB 1037 (Frommer, 2005/2006), as amended on August 7, 2006, would have created a three-factor, quadruple-weighted sales, apportionment formula for certain industries. AB 1037 was held in the Senate Revenue and Taxation Committee.

AB 2590 (Campbell, 2003/2004) and AB 2560 (Vargas, 2001/2002) would have replaced the three-factor, double-weighted sales apportionment formula used by most corporations with a single-factor apportionment formula based solely on sales. Exceptions to using the single-factor formula would have included: (1) taxpayers that had an average of property and payroll in California in excess of sales that did not meet certain employment requirements would use the three-factor, double-weighted sales formula, and (2) taxpayers that derive more than 50% of their gross business receipts from extractive activities could have used either the single-factor sales formula or the three-factor, single-weighted sales formula. AB 2590 and 2560 were held in Assembly Appropriations.

AB 1642 (Harmon, 2001/2002) and SB 1014 (Johnson, 2001/2002) would have changed the apportionment formula used to determine the amount of business income taxable by California to a single-factor apportionment formula based on sales and allowed extractive businesses to choose either the current three-factor formula based on property, payroll, and sales, or use the new single-factor formula. AB 1642 died pursuant to Article IV, Section 10(c) of the Constitution; SB 1014 was returned to the Secretary of Senate pursuant to Joint Rule 56.

## OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

General research was performed to determine how these other states "weight" the sales factor in their apportionment formula.

*Florida and Massachusetts* generally use a double-weighted sales factor with some exceptions for specialized industries.

*Illinois* began using the single sales factor for tax years ending on or after December 31, 2000. The single sales factor formula is used by corporations deriving business income from the state, rather than being determined by a corporation's principal business activity code.

*Michigan's* apportionment formula consists of 5% payroll, 5% property, and 90% sales.

*Minnesota's* apportionment formula consists of 12.5% property, 12.5% payroll, and 75% sales for tax years beginning before 2007. In 2005, *Minnesota* enacted legislation to phase in a sales-only formula over an eight-year period beginning in 2007.

*New York* utilizes a business allocation formula to assign income from business capital to *New York*. For tax year 2006, *New York* will begin the process of phasing in a new, single-factor allocation formula based on in-state receipts. The single-factor allocation formula will be phased-in as follows: (1) for tax year 2006, the business allocation formula will be equal to 20% property, 60% sales, and 20% payroll; (2) for tax year 2007, the business allocation formula will be equal to 10% property, 80% sales, and 10% payroll; and (3) for tax years beginning on or after January 1, 2008, the business allocation formula will consist of 100% sales.

## FISCAL IMPACT

Departmental costs to implement this provision are estimated at approximately \$85,000 in the first year and approximately \$160,000 in each year thereafter.

Implementing this bill in the first year would require modifications to the department's information systems, tax forms and instructions, and additional customer service contacts from taxpayers seeking clarification on the election for the two new apportionment methods and filing requirements. Estimated annual costs include additional audit staff needed to examine the new alternative apportionment method and process elections and unused additional sales factor carryovers. In addition, annual costs include auditor training, customer service contacts, and information systems support.

It is recommended that the bill be amended to include appropriation language that would provide funding to implement this provision. Lack of an appropriation will require the department to secure the funding through the normal budgetary process, which could delay implementation of this provision if funding is not approved by the Department of Finance.

## **LEGAL IMPACT**

This provision would preface whether a member may use the proposed alternative apportionment method based on the level of activity in this state, which could be subject to constitutional challenge under the Commerce Clause of the United States Constitution. Possible constitutional issues found in the bill include the definition of qualified expenditures that are defined as only California property or expenses incurred in the state along with property and payroll in the state.

## **POLICY CONCERNS**

The intended effect of encouraging business to expand in California would only apply to apportioning trades or businesses if this bill were adopted. A business located in California that is wholly in state would receive no benefit from this provision because wholly in-state businesses do not apportion their income.

## **LEGISLATIVE STAFF CONTACT**

Anne Mazur  
Franchise Tax Board  
(916) 845-5404  
[anne.mazur@ftb.ca.gov](mailto:anne.mazur@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
(916) 845-6333  
[brian.putler@ftb.ca.gov](mailto:brian.putler@ftb.ca.gov)

Analyst	Anne Mazur
Telephone #	916-845-5404
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SB 98  
As Amended July 20, 2007

AMENDMENT 1

On page 20, line 6, ~~strikeout (i) and strikeout lines 15 through 18,~~  
inclusive.

AMENDMENT 2

On page 22, line 3, ~~strikeout "assigned or"~~

AMENDMENT 3

On page 23, line 24, ~~strikeout "State Board of Equalization and the"~~

AMENDMENT 4

On page 27, on line 3, ~~strikeout (i) and strikeout lines 12 through~~  
15, inclusive.

AMENDMENT 5

On page 28, lines 26, 27, and 35, ~~strikeout "qualified taxpayer" and~~  
insert:  
qualified commercial production company

AMENDMENT 6

On page 29, line 5, ~~strikeout "assigned or"~~

AMENDMENT 7

On page 30, line 28, ~~strikeout "qualified taxpayer" and insert"~~  
qualified commercial production company

AMENDMENT 8

Beginning on page 31, line 33, through page 35, line 19, ~~strikeout~~  
Section 7 of the bill.

AMENDMENT 9

On page 45, line 34, ~~strikeout~~ "assigned or"

AMENDMENT 10

On page 45, line 18, ~~strikeout~~ "State Board of Equalization and the"

AMENDMENT 11

On page 52, line 35, ~~strikeout~~ "assigned or"

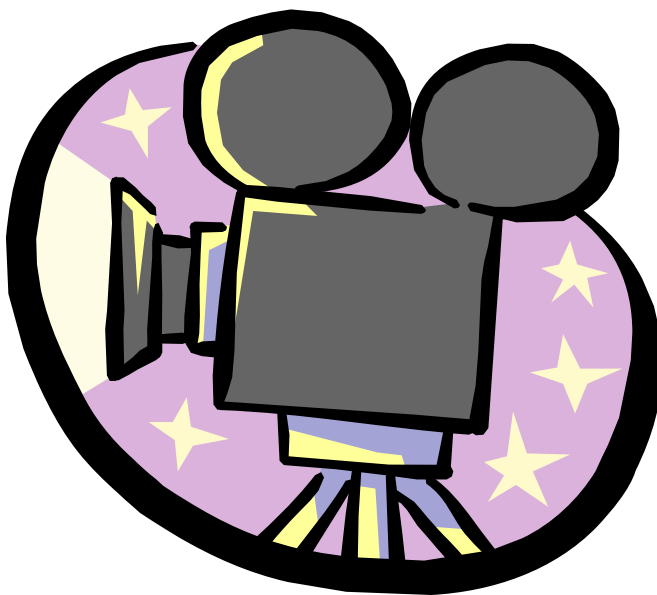
Appendix



**MOTION PICTURE ASSOCIATION OF AMERICA, INC.**

**2007 STATE-BY-STATE TAX INCENTIVES**

**FOR THE FILM INDUSTRY**



Compiled by Angela Miele  
Vice President, State Tax Policy  
[amiele@mpaa.org](mailto:amiele@mpaa.org)  
908-668-9912

STATE	TAX INCENTIVES July 25, 2007
<b>Alabama:</b>	State and local sales and use tax exemption for the purchase or lease of equipment, props, supplies, materials and services used in production. Additionally, no state and local lodgings tax for rooms used by production staff.
<b>Alaska:</b>	No state sales tax. No state individual income tax.
<b>Arizona:</b>	A tiered transferable income tax credit for in-state expenditures spending \$250,000 - \$1million, a 10% credit; between \$1million-\$3million a 15% credit; over \$3million a 20% credit, includes a 5-yr.carryforward provision requires the hiring of at least 25% of full time employees in 2006, 35% in 2007 and 50% in 2008. If the year's allocation (\$30M – 06; \$40M – 07; \$50M – 08; \$60M - 09; \$70M – 2010 and after) is spent prior to 10/31, Dept. can rollover application to next year's credits. Also beginning 1/1/2006, a motion picture production company is exempt from the transaction privilege tax for purchase of machinery, equipment and other property used directly in the motion picture production, lodging leases or rentals, catered food and construction of in-state buildings or structures.
<b>Arkansas:</b>	Full gross receipts and use tax refund on the purchase of property and services including lodging in connection with production costs. To qualify, a production company must spend at least \$500,000 within six months or \$1 million within 12 months in connection with the production.
<b>California:</b>	<p>No sales or use tax on production or postproduction services on a motion picture or TV film. No sales and use tax on services generally. Such industry specific services include writing, acting, directing, casting and storyboarding. A partial sales tax exemption (5% except for 2001, when it was 4.75%) on the purchase or lease of postproduction equipment by qualified persons.</p> <p>No sales and use tax on 45% of the charges for sets, including labor to design, construct and strike and no sales tax on the full charge for the rental of personal property.</p> <p>No state hotel tax on occupancy, however, cities or counties that impose a local tax have a tax exemption for occupancies in excess of 30 days.</p>
<b>Colorado:</b>	<p>A 10% refund: For a production company that originates the film production in Colorado the 10% refund if the in-state expenditures equal or exceed \$100,000; For a production company not originating the film production activities in Colorado the 10% refund if in-state expenditures equal or exceed \$1 million. Must spend at least 75% of its production expenditures in state and 75% of the actors and crew must be Colorado residents. Annual statewide cap is \$500,000 for 2006-07 and increases with inflation in subsequent years.</p> <p>No sales and use tax on film company services if, in fact, the company is providing a service and not tangible personal property. No hotel Occupancy tax for hotel stays in excess of 30 days.</p>

## MPAA STATE BY STATE TAX INCENTIVES

STATE	TAX INCENTIVES July 25, 2007
<b>Connecticut:</b>	<p>Provides a 30% transferable production tax credit on expenditures related to film, TV and digital media with a minimum in-state spend of \$50,000. The credit for compensation paid is capped at the first \$15 million (1/1/08). Production credits may be carried forward for 3 years. Beginning 1/1/09, only 50% of expenses or costs will be allowed when incurred outside the state and used within the state.</p> <p>No hotel occupancy tax for hotel stays in excess of 30 days.</p>
<b>Delaware:</b>	No state sales tax.
<b>Florida:</b>	<p>Sales and use tax exemption for the purchase or lease of motion picture, video or other equipment (depreciable equipment with a useful life of at least three years) if used exclusively as an integral part of production activities in the preparation of motion pictures, tapes, TV or productions produced for commercial use or sale. If equipment and personnel used belong to the producer of a qualified motion picture, no tax on fabrication labor Subject to annual appropriation (\$25 million 2007-08) Rebate program on in-state expenditures. There are 4 queues; 1) Films, TV, commercials music videos, expenditures in excess of \$650,000 get a 15-22% rebate, 2) multiple commercials/ music videos minimum combined expenditures of \$500,000 and a \$100,000 per project minimum get 15-20% rebate, 3) Indies spending \$100,000-\$625,000 get 15%-17% rebate, 4) Digital media projects -10% rebate. No state individual income tax.</p>
<b>Georgia:</b>	<p>Sales and use tax exemption for the purchase or lease of a wide range of production and postproduction equipment and services for use in qualified production activities in the state. Beginning with tax years on or after 1/1/2005, transferable income tax credit equal to 9% of all in-state costs for in-state film and TV investments of \$500,000 or more. Additional 3% credit on wages (up to \$500,000) paid to GA residents and 3% credit for productions in designated distressed communities. An additional 2% credit for TV productions that spend more than \$20 million.</p>
<b>Hawaii:</b>	<p>Effective 7/1/06, a refundable income tax credit of 15% (for production in counties with a population greater than 700,000) or 20% (for production in counties with a population equal to or less than 700,000), which is deductible from net income tax liability, of the costs incurred in the state in the production of motion picture and television films, and up to 7.25% rebate for the for transient accommodation tax (hotel room tax). Must spend at least \$200,000 in Hawaii. Overall cap of \$8M. Repealed on 1/1/2016.</p>
<b>Idaho:</b>	No hotel occupancy tax on hotel stays of 30 days or longer.

## MPAA STATE BY STATE TAX INCENTIVES

STATE	TAX INCENTIVES July 25, 2007
<b>Illinois:</b>	<p>Sales and use tax exemption for products of photoprocessing produced for use in motion pictures for public commercial exhibition.</p> <p>A transferable 20% income tax credit for Illinois production expenditures, plus a 15% credit for Illinois labor expenditures capped at the first \$100,00 in wages for each employee. Repealed 1/1/08. The 14.9% hotel tax is reimbursed for stays in excess of 30 days.</p>
<b>Indiana:</b>	<p>State-owned and state university owned property is available free of location fees for virtually all productions. Production related businesses with tax liability in Indiana can qualify for up to a 10% tax credit based on investment in equipment or buildings. No hotel tax on stays of 30 days or longer.</p>
<b>Iowa:</b>	<p>Beginning in 2007, a transferable Iowa income tax credit based on 25% of qualified in-state expenditures go to the "Producer" if there is a minimum in-state spend of \$100,000 based exclusively on Iowa-based companies or Iowa resident individuals. Transferable Iowa income tax credit based on 25% of qualified in-state expenditures to go to the "Investor."</p>
<b>Kansas:</b>	<p>A credit equal to 30% of in-state production and postproduction related expenditures including wages, fringes, and payments to personal services corporations under certain conditions. Minimum in-state spend of \$100,000 for productions over 30 minutes. Credits are capped at \$2 million annually. No hotel tax on stays of 28 days or longer.</p>
<b>Kentucky:</b>	<p>Sales and use tax refund for purchases made by a motion picture production company in connection with filming in Kentucky if the company films or produces one or more motion pictures in the state during any 12-month period.</p>
<b>Louisiana:</b>	<p>Provides a transferable investor tax credit equal to 25% of the in-state investment made if it is in excess of \$300,000. Beginning 1/1/2006, the employment tax credit will be transferable and equal to 10% of the salaries in-state residents hired (no salaries in excess of \$1million will qualify). (New program includes an alternative option to transfer credits through the Governor's Office.)</p>
<b>Maine:</b>	<p>A wage rebate equal to 10% of non-Maine residents' wages and 12% of Maine residents' wages on qualified productions. Income tax offset for companies investing in Maine productions.</p> <p>Sales and use tax exemption for tangible personal property and services used primarily in production. Revenue Department Ruling in 2004 proclaimed film production a manufacturing process. Hotel occupancy taxes are rebated after 28 consecutive days.</p>
<b>Maryland:</b>	<p>State sales and use tax exemption for the purchase or lease of production or postproduction equipment, services, supplies, props and sets used in the production of motion picture, television, video, commercials and corporate films. No state sales tax for hotel stays in excess of 30 days. Subject to additional appropriation, wage rebate program, up to \$12,500 per eligible employee for film and television production activity in the state if in-state spending exceeds \$500,000. The maximum rebate granted for any single production is capped at \$2 million state capped total rebates of \$6.875 million.</p>

## MPAA STATE BY STATE TAX INCENTIVES

STATE	TAX INCENTIVES July 25, 2007
<b>Massachusetts:</b>	Beginning 1/1/2007 a choice of a transferable employment credit (or refundable credit equal to 90% of the credit value), equal to 25% of Massachusetts sourced income, if an individual's salary is not equal to or greater than \$1 million. The incentive also includes a film production tax credit (FPTC) equal to 25% of in-state production costs (not including payroll expenses used to claim the payroll credit) if 50% of the total production costs or 50% of principal photography days occur in the state. There is a minimum in-state spending requirement of \$50,000 in order to qualify for all the production incentives and the payroll and FPTC include a five-year carry forward provision.
<b>Michigan:</b>	Beginning 1/1/2007, a refundable tax credit (essentially a rebate) for motion pictures, television series or pilots and commercials (once they spend a minimum of \$200,000 in state). There is a graduated scale for the rebate amount depending on the amount of in-state spend, ranging from a 12% to a 20% refund. The funding for the entire program is capped at \$7 million each tax year 10/1-9/30.
<b>Mississippi:</b>	Effective March 2007. For all feature films, television projects, documentaries, or commercials: a 20% rebate of all base investment in-state production-related expenditures, excluding non-resident payroll. 25% rebate for the next four million dollars (between \$1 million and \$5 million) and a 30% rebate of the base investment that is in excess of \$5 million. Rebate capped at \$5 million per production; A rebate equal to 10% of the portion of the base investment for non-resident employees' salaries less than \$1 million, subject to income tax withholding. a reduced sales tax (7% to 1½ %) for motion picture equipment (camera, lighting, audio, projection, editing, etc.); a sales tax exemption for the purchase of film, videotape, set building materials, set dressing, props, wardrobe, fabric, make-up, most expendable items. Sunset July 1, 2012.
<b>Missouri:</b>	Provides a transferable/carry forward (5yrs) income tax credit up to 50% of expenditures in the state to a maximum of \$1 million in tax credits per project. Productions must spend a minimum of \$300,000 in the state. \$1.5 million/year available for total credits. No sales tax on hotel stays after 31 days.
<b>Montana</b>	No state sales tax. No business equipment tax on motion picture related vehicles and equipment brought into the state for the first 180 days. State 7% accommodations tax rebate for stays in excess of 30 days. Film and TV productions eligible for a 12% refundable tax credit on up to \$50,000 in wages paid to Montana residents. Also a refundable tax credit of 8 percent on their total spending in the state. Credits may also be carried forward for 4 years. Both credits capped at \$1 million per production. Expires 1/1/2010.
<b>Nevada:</b>	No corporate or individual Income tax. Low hotel room tax.
<b>New Hampshire:</b>	No state sales tax. Individual Income tax on interest and dividends only.

## MPAA STATE BY STATE TAX INCENTIVES

STATE	TAX INCENTIVES July 25, 2007
<b>New Jersey:</b>	Sales tax exemption for all film and video related machinery and equipment as well as services of installing, repairing and maintaining the equipment, used directly in production and post production of motion pictures, television or commercials. Loan Guarantee Program up to a maximum of \$1,500,000 (or an amount no greater than 30% of any loan for the film project that is derived from other sources, whichever is less), to production companies if 70% of the shooting days are in the state and at least 50% of the below-the-line expenses are in state. Beginning 1/12/2006 the state will provide a transferable corporate and income tax credit equal to 20% of in-state production related expenses for films, TV shows and series. Additionally, sixty percent of the total production expenses, excluding post-production costs, must be incurred in the state. The program is capped at \$10 million per fiscal year and includes a roll-over provision. If the \$10 million is exhausted in any fiscal year, any remaining qualified taxpayers will be first to receive the credit in the subsequent fiscal year. The incentive applies to taxable years beginning on or after July 1, 2005 and sunsets with taxable years beginning after July 1, 2015.
<b>New Mexico:</b>	State sales tax exemption on all production costs including set construction, wardrobe, facility and equipment rental, all production and postproduction services. A 25% refundable income tax credit on in-state film production and postproduction expenditures. Also, guaranteed investments may be considered for up to 100% of the estimated production costs, capped at \$15 million per project. Loan structures would have to be "fully and unconditionally guaranteed" by an entity with an investment grade bond rating; and equity structures require presales/distribution. After 30 days, the 4% lodgers tax is waived for hotel guests.
<b>New York:</b>	Comprehensive State, New York City and local sales and use tax exemption for machinery, equipment and services used in production and postproduction activities in the production of feature length films, television programs, music videos and commercials. Film and television and commercial productions receive tax exemptions whether they are produced and delivered electronically or in tangible form. A 10% corporate/partnership/individual refundable income tax credit for film and television productions (no commercials or music videos) for below-the-line in-state expenses including postproduction (and actors with non-speaking roles) if 75% of the aggregate sound stage work (excluding postproduction) is performed in a NY production facility at least 7,000 square feet. The credit is 50% refundable in the first year and fully refundable after 2 years. If less than \$3 million (excluding postproduction) is attributed to the production facility related costs, then 75% of the aggregate shooting days outside of the facility must be in NY in order for NY location costs to qualify for the credit. Effective in 2006, credit is capped at \$60 million/calendar year, the cap is a rolling cap; if the cap is exhausted in one year the projects will be eligible in the following year on a first-come first-served basis. An additional 5% refundable tax credit against corporate, partnership, or unincorporated business tax liability against New York City tax liability with the same qualification parameters as the state credit. The City's annual credit cap is \$30 million. NYC also offers a discount card to productions for the length of their New York City shoots. It provides a minimum 10% discount and other special offers at over 550 local vendors ranging from production services, hotels, car rentals, parking, cultural institutions, banking services and more.

## MPAA STATE BY STATE TAX INCENTIVES

STATE	TAX INCENTIVES July 25, 2007
<b>North Carolina:</b>	Refundable income tax credit equal to 15% of qualifying production expenses for in-state leased or purchased items, must have qualifying in-state expenses of at least \$250,000 (effective 1/1/07 no add-back requirement). Limitations: per feature credit cap of \$7.5 million and assets purchased in excess of \$25,000, qualifying expense limited to the purchase price less the fair market value of the asset at the completion of the production. No wages for individuals earning in excess of \$1 million for a single production. Sales and use tax (1%) rate, on the purchase and rentals to motion picture production firms of cameras, films, set construction materials, as well as chemicals and equipment used to develop and edit film that is used to produce release prints.
<b>Ohio:</b>	No state sales tax on hotel stays in excess of 30 days.
<b>Oklahoma:</b>	<p>Oklahoma Film Enhancement Rebate now funded up to \$5 million per year. Provides a rebate of up to 15% of Oklahoma production expenditures for films/TV/Commercials filming in the state. Minimum production budget of \$500,000 and \$300,000 spent in Oklahoma. Must employ residents for at least 50% of B-T-L crew to qualify for full 15% rebate. Rebates of 5% for up to 24% Oklahomans and 10% for 25 to 49% Oklahomans. Crew tiers are waived for \$5 million in-state spend. Company must provide evidence of a completion bond and evidence of a recognizable domestic or foreign distribution agreement within one (1) year from the end of principal photography. The rebate cannot be used in conjunction with the sales tax exemption.</p> <p>Sales tax exemption on sales of tangible, personal property or services to a motion picture or television production company to be used or consumed in connection with a feature or television production. State sales tax rebate on hotel stays after 30 days.</p>
<b>Oregon:</b>	Beginning with expenditures incurred 1/1/05 Oregon Production Investment fund offers a 10% rebate on production expenditures in Oregon (capped at \$250K maximum rebate for an individual film and \$30,000 per episode for a television series.) Minimum \$1 million spending to qualify. (\$1 million can be over a season of the series). They can only commit rebates to productions to the extent that there are monies in the fund to cover those rebates. Beginning Fall, 2005, rebates are available for approximately 6.2% of qualified wages to productions. Productions must spend at least \$1-million in Oregon to qualify. No state sales tax. Lodging taxes waived for rooms held longer than 30 days. Other local incentives including parking rebates up to \$1,000 of parking fees incurred within Multnomah County (Portland area) for every 100-hotel room nights purchased.
<b>Pennsylvania:</b>	<p>A 6% sales and use tax exemption for the purchase or rental of any tangible personal property and services in Pennsylvania used directly in the production or post production of a feature length commercial motion picture distributed to a national audience.</p> <p>Effective 5/2/06, replaced production tax incentive with grant program for in-state production expenditures. Grant is 20% of qualified production expenses, provided 60% of total production expenditures occur in PA. Overall annual cap of \$10 million. Administered through Dept. of Community and Economic Development.</p>

## MPAA STATE BY STATE TAX INCENTIVES

<b>Puerto Rico:</b>	Provides Up to a 40% investment tax credit is available for motion picture and television expenditures paid to Puerto Rico Businesses or below the line talent if at least 50% principal photography is in Puerto Rico. The credit is available for projects first approved by the Film Commission once applicants pay ¼ of 1% of the film's budget for a license. Local investors will partner with non-Puerto Rican based companies to help them access the investment tax credit.
<b>Rhode Island:</b>	<p>For productions filing with RI film office on or after January 1, 2005, provides a 25% motion picture transferable tax credit for all Rhode Island production related expenditures. This also includes salaries for people working on the ground, in R.I. The film/TV/commercials/ video game production must be filmed primarily in the state of Rhode Island and have a minimum budget of \$300,000.</p> <p>Additionally there is also a non-transferable investor tax credit for Rhode Island residents who invest in film/TV/commercials or video games filmed primarily in Rhode Island. The investor will receive a 15% tax credit (with a 3 year carryforward) for a production with a budget of \$300,000-\$5million. If the investment is in a production with a budget over \$5million, it is a 25% tax credit (with a 3 year carryforward).</p>
<b>South Carolina:</b>	If you spend \$250,000 in-state: available sales and use tax exemption for the purchase of equipment and supplies and an exemption for the State accommodations tax (7%), if you spend \$1 million in-state you receive a maximum of 20% rebate for total aggregate payroll for persons (crew, actors, extras) subject to SC income tax withholding (excludes individual salaries of \$1 million or more) this is capped at \$10 Million per year and up to a 30% rebate for purchases/rentals of certain in-state goods and services.
<b>South Dakota:</b>	Refund for contractors' excise, sales and use taxes paid in connection with films spending over \$250,000 (on taxable costs) in the state. The 4% refunds apply to costs incurred and paid after July 1, 2006 - June 30, 2011.
<b>Tennessee:</b>	<p>Effective 2007, Tiered rebate program for in-state qualified production expenditures 13% base rebate, 2% additional rebate if at least 25% of the cast and/or crew are Tennessee residents. ("Day players" and extras not included in determining the 25%), an additional 2% (maximum of \$100,000 rebate) if the production company spends at least \$20,000 for music created by Tennessee residents or for recording music in Tennessee. Out of state production companies must spend a minimum of \$500,000 per production. Approximately \$20 million appropriated for the rebate program.</p> <p>Sales and use tax refund for out-of-state motion picture companies for goods and services purchased or rented in Tennessee if the company spends at least \$500,000 within a 12-month period.</p>
<b>Texas:</b>	<p>Effective in 2007, a rebate program equal to 5% for film, TV, video game productions and commercials. \$1 million minimum in-state spend for film and TV productions, 70% of production crew, actors and extras must be Texas residents, 80% of the production must be filmed in Texas. Cap per film is \$2 million, \$2.5 million cap for TV productions, \$250,000 for video games. Program funding is \$10 million per year for 2 years (plus an additional \$1 million per year for administrative and training expenses); additional funds (in \$5 million increments) will be available for projects for approved plans justifying the fiscal activity that exceeds the cost of the additional grant amounts requested.</p> <p>Comprehensive sales and use tax exemption for purchased or rented equipment or services used in the production of a motion picture or a video recording for ultimate sale, license or broadcast (including cable broadcast).</p> <p>No sales tax on hotel rooms for stays in excess of 30 days.</p>

## MPAA STATE BY STATE TAX INCENTIVES

STATE	TAX INCENTIVES July 25, 2007
<b>Utah:</b>	State sales and use tax exemption for the purchase, lease or rental of machinery and equipment used in the production or postproduction of motion picture, television, music video or commercial productions. 10% rebate for television series and television movies, capped at \$100,000 per episode or \$750,000 per funding cycle; feature films are capped at \$500,000 per production. Transient room tax rebate on hotel stays of 30 days or more.
<b>Vermont:</b>	State sales and use tax exemption for the purchase or lease of goods and services used in the production of films, television programs or commercials. Credit for nonresident income tax for commercial film production if Vermont income tax exceeds income tax rate in the state of residence. No hotel or meal tax after 30 days. Effective 7/1/06, a qualified production with at least \$1 million in VT production expenditures can apply for a grant of 10% of qualified production expenditures. Annual overall cap of \$1 million.
<b>Virginia:</b>	Effective July 1, 2006 - \$1.2 Million funding for a performance-based incentive will provide a cash rebate at the Governor's discretion, taking into consideration length of filming, job creation, trainees hired, goods and services purchased. The rebate will be paid to qualified production companies at the end of physical production and payment will be issued upon completion of a report of Virginia expenditures. Additional state incentives include an exemption from state sales and use taxes and hotel taxes for stays of 30 days or more in many localities. In most cases, state owned locations are provided free of charge. Based on availability, use of a state owned 35,000 square foot office building (Richmond) for office and production is accessible. The Film Office specializing in assisting in negotiating other free or low cost locations that have historically resulted in significant savings to productions shooting in the state.
<b>Washington:</b>	<p>Effective June 30, 2006, a rebate of 20% of qualified production expenses on a feature film with expenditures in WA of at least \$500,000 and \$300,000 for a television episode. Per production cap of \$1 million. Overall cap of \$3.5 million.</p> <p>Sales and use tax exemption for the purchase or rental of production equipment and services used in motion picture or video production or post-production. No sales and use tax on vehicles used in production.</p> <p>No tax on hotel stays in excess of 30 days.</p> <p>No state individual income tax.</p>
<b>Washington DC:</b>	Effective immediately, a grant program funded at \$1.6 million annually, to reimburse productions for expenses related to the production of nationally distributed film and television projects that spend a minimum of \$500,000 in qualified expenses in a period of five or more days within DC. The grant will not exceed the lesser of 10% of the qualified expenses or 100% of the taxes paid to DC on the qualified expenses.
<b>Wisconsin</b>	Effective for productions after December 31, 2007, refundable individual/corporate income/franchise tax credit equal to 25% of in-state production-related expenditures and a non-refundable wage credit equal to 25% up to the first \$25,000 for in-state wages (excluding the 2 highest paid employees). Also provides for a credit equal to sales/use tax paid on purchases of tangible personal property and taxable services directly used in a production. The unused sales/use tax credit may be carried forward for 15 years.

## MPAA STATE BY STATE TAX INCENTIVES

STATE	TAX INCENTIVES	July 25, 2007
<b>Wyoming:</b>	<p>Funds will be available 7/1/07 for a rebate program equal to 15% on in-state production related purchases, leases, salaries and benefits (except the two highest paid actors) if a minimum of \$500,000 is spent in state. The rebate also covers payments for preproduction, production, post-production and digital media effects services rendered in the state. The annual cap for the program is \$1 million. Wyoming businesses offer production companies filming in Wyoming a 10% discount on production related services including hotels/motels, restaurants, caterers, etc. No tax on hotel stays in excess of 30 days.</p> <p>No state corporate or individual income tax.</p>	

For individual state film office websites, visit: [Http://www.afci.org](http://www.afci.org)